

BIGGEST CZECH BANKS IN THE MIRROR OF ANNUAL REPORTS

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Abstract:

The aim of the Paper is to characterise and analyse the biggest Czech banks Annual reports (ARs). Since 2004, the behaviour of Czech banks has been changing, as can be seen – inter alia - from the big banks' financial statements and annual reports. During the period of 2007 – 2013 the implementation of IFRS continued and its impact on the institutional structure of banking is visible. From the point of view of banks, annual reports present not only the financial results, but they serve as an important instrument of competition and marketing as well. Comparative analysis of the three Czech leading banks gives a picture of their specific features as reflected in their annual statements.

Key words: financial reporting, annual reports, IFRS, European reporting trends, Czech law on accounting

JEL Classification: G.21, M.41, M.42

I. INTRODUCTION

The aim of the paper is to analyse the changing behaviour of three Czech big banks and the changes in their institutional role as reflected in their annual reports. The research object represents the 21 annual reports of the three leaders in the Czech banking system during the period of 2007 – 2013. Three questions are discussed: 1. What was the impact of legislative changes on selected Czech banks and their annual reports? 2. What are the common and specific features of the compared annual reports? 3. Do the annual reports of the compared banks follow the European trends? The annual reports cannot be analysed *per se*, therefore, selected data on the actual state of the Czech banking system, character of competition, and the banking legislation are briefly characterised.

Before starting our analysis, it is useful to explain, how annual reports are understood in the Czech Republic. Generally speaking, annual reports are documents reporting on companies' activities throughout the preceding year. In different countries, annual reports functions, scope and other features are differently embodied in laws. Therefore, a comparative analysis is very difficult. Because of the continuing globalization processes, there is a strong tendency to upgrade the existing common reporting standards, evaluation methods (such as rating, screening etc.) and recommended practical approaches to different agendas connected with annual reports, called „best practice“, within the activities of IFRS Foundation, IASB and national authorities, such as the British Financial Reporting.

By the Czech law on Accounting, annual reports are not *expressis verbis* defined. Instead, an instrumental definition is applied, i.e. annual reports' function is described (§ 21): the aim of annual reports is to inform in a balanced and comprehensive form on companies' efficiency, activity and their economic position. At the same time, annual reports include other important items as well, such as the financial statement, auditors' reports etc. Annual reports have to be passed to the official authorities within 30 days (after fulfilment of specific conditions) or – in special cases – within one year at the latest. Companies' annual reports have to be published. For Czech banks reporting, some specific rules exist. (See more in section II of this paper)

There is a good reason to limit our analysis on the three top Czech banks (Česká spořitelna – CSAS, Československá obchodní banka - CSOB and Komerční banka - KB), because of their unique position in the Czech banking system. At present, Czech banking is the largest in the post-socialist Middle Europe; its actives of total worth exceed 119% of GDP. (Kabelik, 2014, p. 165.) The above three banks are owned by foreign capital and they control approx. 95% of actives of the banking sector (ČNB, 2013, p. 55). In 2013, the average ROE of the above banks was 15.6%. (Deloitte (2014), p. 64.) Owing to the big three bank dominance, the Czech banking sector is highly concentrated and the type of competition is oligopolistic, as “banking is leaned toward oligopoly model.” (Aloshyna, 2013, p. 24). For understanding the behavioural and institutional aspects of the Czech banking, this fact is crucial.

II. CZECH LEGISLATION ON ANNUAL REPORTS

Since 2004, when the Czech Republic became EU member, many law had to be (step by step) amended. During the years 2004 – 2013, the Law on banks was 25 times modified. Similarly, the Law on accounting was modified 26 times. Czech banks had to bear higher costs and increased risks, the regulatory risk included. According to the Law on banks, 16 types of activities can be performed. However, the range of activities/services is still narrower than in core banks in EU.

Annual reports were newly regulated by the law on accounting (No 59/2012 Coll.) The application of IFRS international accounting standards in financial statements is regulated by § 18a, par. 1, in a differentiated way for different entities. For example, non-issuers of securities (according to § 22, par. 8) were obliged to include 4 items into ARs, namely, 1. an audited balance 2. a report on audit (§ 21, par. 4), 3. A report on relations between the controlling and controlled person (according to the Law on business companies and co-operatives, § 436, 4. a report of the Board on business activities and on company assets, and 5. a text compiled according to the § 21 of the Law on accounting. As the banks have the form of a joint stock company, they have to include their audit into the ARs (§ 20, par. 1a, of the Law No 21/1991 Coll.). According to § 23 of the Law on banks No 21/1992 Coll. Banks have the obligation to produce ARs and to present them in due time. According to the Law on accounting, an AR has to include information on the expected development of the entity, on activities in the area of research and development, on ecological activities, on labour relations and some other information as well. The ARs have to inform on goals and methods of risk management, on financial derivatives' transactions, on price, credit and liquidity risks and on cash-flow risks. Financial statements are an obligatory part of ARs.

Czech central bank (ČNB – Česká národní banka) is the standard setter for control system of banks, risk management systems, accounting and other matters connected with IFRS. Central bank has the right to decide about necessary changes of Czech secondary legislation concerning IFRS application in banks.

To resume: the impact of legislative changes on selected banks and their annual reports: the above changes had impact not only on the content and extent of the ARs, but the ARs form was influenced. The new reporting requirements had an important impact on banks' internal orders and the structure of organisation as well.

III. ANNUAL REPORTS COMPARED

To be able to show how behaviour of the three big banks (during the period 2007-2013) was changing, a special set of data was set up. This set is composed of different types of data: 1. data on compliance (3 items: deposition with Collection of documents; post deadline deposition; auditors companies); 2. data on completeness and comprehensiveness (2 items: all obligatory parts reported; first parts' specific features); 3. data on marketing value - primarily related to the 1st part of annual reports (7 items: total volume; CEO report volume; financial parts' volume; intelligibility; expected degree of financial literacy; information quality; marketing quality); 4. data on the form of publication (4 items: printed reports; quality of design; design prepared by external company). In total, 16 items were selected and examined in 7 annual reports for each bank. The analysis begins from the year 2007, i.e. the first year of important changes in the Czech legislation (after joining EU in 2004).

The above list draws on literature about financial statements' analysis and different analytical methods used to financial statements and annual reports evaluation. In the vast literature on financial statements, numerous recommendations about the way how the statements and annual reports should be prepared, and how annual reports should look like, are currently published (IASB documents on Conceptual Framework of IFRS, as of 2015). Our paper draws, for example, on information about the annual report content (enumeration of reporting items and reporting areas on Reportwatch), on common errors to be found in annual reports (Fernandes, P. and Bilan, A., 2015), on current trends in reporting (Guillaume, 2015), and documents published by the British Financial Reporting Council (FRC, 2015).

In this section, the approach to the three big Czech banks' annual reports is empirical; it is not based on any distinct theory; primarily, it is based on empirical evidence. The reports' analyses were discussed with selected experts from the analysed banks (interviews). Brief results (without tables) are presented, arranged according to the above criteria.

What was common to the all three banks' annual reports: 1. All 3 examined banks duly deposited their reports with the Collection (however, 4 reports of the KB and 2 reports of CSAS were deposited with a longer delay). 2. The auditors' services market was dominated by the Ernst and Young company (with the following exceptions: CSAS employed the company Deloitte in 2007 and 2008; KBa – Deloitte in 2007, 2008, 2009). 3. IFRS data were used by all banks (with certain specific modifications – see later). 4. All obligatory parts were presented by all the banks - however, in a different way (different volume, range etc.- see later). 5. In general, information and marketing quality of all 21 annual reports – in comparison with majority of big players in other

Czech industries – was good, and was improving. 6. Intelligibility of most reports was very good. Financial reports were difficult, expected degree of readers' financial literacy was high.

Specific (selected) features of the three banks' first parts of annual reports are briefly summarized (according to selected criteria): 1. All obligatory items are reported in all ARs compared. The main differences consist in a different extent of individual items, in the items' ranging, and in the titles identification (specific wording). In some cases, these differences make the analysis difficult, because materially, some titles are not fully comparable. In all ARs, KB informs its shareholders about its shares' structure and prices. Other banks' ARs do not contain this special information. KB informs on its employment policy, the other banks were not used to do so. CSOB prefers to place its CEO report at the beginning of all ARs. In all ARs of CSAS the banks' profile followed by a survey of the current years' event is presented; only then CEO report is placed. In CSAS ARs, the range of items is not changed, i.e. the users easily can find the information on the same place; they have not to run through many pages as the users of both other banks have to. These examples show the diversity of compared ARs. It has to be pointed that the compared banks' reaction on the world financial crisis was differentiated; the crisis did not hit all the three banks at the same time. 2. The total volume of annual reports (as measured by number of pages) widely differs. CSOB published the longest reports of all banks - AR (2012) which contains 350 pp., and the shortest one of 205 pp. (2008). As measured by the number of MB, the longest – of all banks – is the KB AR (2012) with 10, 3 MB, the shortest – of all banks – is the CSAS AR (2007) with 1,54 MB. The differences between the two methods evidently are due to the number and size of photos, event diagrams, which is misleading. It is probable that from the point of view of the desirable influence on ARs' users, banks were normally trying to publish ARs approximately of the same volume in the same year; but it is no common rule. More important evidently is the first part of ARs which precedes the financial part (general destined for expert people with a high degree of financial literacy). The volume of the ARs 1st parts generally does not exceed approx. 60-70 pages which is the maximum tolerated by most non-professional users. 3. Let us compare another interesting point – the volume of CEOs information addressed “to every user.” The absolute “winner” were the CEOs reports of KB (minimum 604 words in 2010 and maximum of 1427 words in 2008); second was the CSAS (with a minimum of 399 words in 2007 and maximum of 577 words in 2013); third was CSOB (with minimum of 237 words in 2009 and maximum of 577 words in 2013). In my opinion, the soundest and most rational way was the way of CSOB- CEO who always presented valuable concise information. 4. There are big differences between the banks concerning the treatment of ARs: the only bank that protected its ARs by copyright was the CSOB. Other banks' ARs are green literature (no copyright, no ISBN, no ISSN). 5. As for ARs design, CSAS employed the company Omega through 2007-2013. CSOB used design services in 2007 (company Omega) and 2008 (company Integraf); during the years 2009-2013, no information on designing was found. KB employed the company Entré in 2012 and 2013. 6. All 21 ARs (2007-2013) were published in an electronic way; no evidence of printed ARs was found, however, they were printed out and distributed (for example, to the banks' subsidiaries).

Our analysis of the third question concerning European trends is based on the fundamental article written by one well-known British specialist (Guillaume, 2014). Apart from the fact that Guillaume's view of trends not always seems to be clear, according to the results of our preceding analysis we contend that approx. 6 of the 10 described trends are followed by the 3 Czech big banks; however, not always by all of them. Trend 1: The tendency of ARs improvement is visible, as far as the quality of information is considered. Trend 3: Czech banks' ARs are more standardised, very often repetitive, however more differentiated (not undifferentiated – evidently because of the prevailing oligopolistic competition). Trend 4: The “rule” of “talk global, work local” is mostly applied by the KB (owned by Société Générale) and by CSOB (owned by KBF). Trend 5: Since 2010, integrated reporting is under way. Trend 6: Channels of reporting are being optimized (Vícha, 2014, p. 2-5). Trend 9: Electronic ARs issuing seems to be preferred, however, ARs are printed out as well. Trend 10: All the three banks are looking forward (it is reflected in ARs).

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V. CONCLUSION

The big Czech banks' ARs reflect the dominant position of these banks in the Czech Republic financial sector. The big banks substantially contribute to financial stability of Czech banking as a whole. At present, the information and marketing quality of big Czech banks ARs is comparable with the quality of ARs of comparable banks in other West European EU countries. Generally speaking, with development of new banking activities the behaviour of big banks is changing in favour of their clients. KB and CSOB follow the general strategy of their mother banks; CSAS is reorienting its strategy. All the three banks are forward oriented and they follow modern trends of EU banking.

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